

1988

First Federal Savings and Loan Association of Salt Lake City v. Gump and Ayers Real Estate, Inc. and Air Terminal Gifts, Inc. : Reply Brief

Utah Court of Appeals

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UTAH COURT OF APPEALS
BRIEF

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DOCKET NO.

88-0331-CA

IN THE SUPREME COURT

STATE OF UTAH

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88-0331-CA

FIRST FEDERAL SAVINGS & LOAN
ASSOCIATION OF SALT LAKE CITY,

Plaintiff/Appellant

vs.

GUMP & AYERS REAL ESTATE, INC.
and AIR TERMINAL GIFTS, INC.,

Defendant/Respondent.

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Supreme Court No. 880080

Category 14(b)

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APPELLANT'S REPLY BRIEF

On Appeal from the Third Judicial District Court
of Salt Lake County, State of Utah
The Honorable Pat B. Brian Presiding

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Clerk, Supreme Court, Utah

IN THE SUPREME COURT

STATE OF UTAH

* * * * *

FIRST FEDERAL SAVINGS & LOAN	:	
ASSOCIATION OF SALT LAKE CITY,	:	
Plaintiff/Appellant	:	Supreme Court No. 880080
	:	
vs.	:	
	:	Category 14(b)
GUMP & AYERS REAL ESTATE, INC.	:	
and AIR TERMINAL GIFTS, INC.,	:	
Defendant/Respondent.	:	

* * * * *

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STATEMENT OF THE CASE

Respondent's Brief in its statement of the case (p.4) has misstatements as follows:

It states that as a finding of fact, the lower court found "that the Air Terminal note contained other powers which negated negotiability". It made no such finding. It merely made a conclusion of law that "it contains other rights". This court is not bound by the lower court's conclusions of law. On appeal, any conclusion of law of the lower court may be reviewed de novo. Graham v. John Deere Co. 383 US 1, 86 S. Ct. 684, 15 L.Ed.2d 545 (1966). Nor should the lower court's construction of a written instrument even be persuasive. Ephraim Theatre Company v. Hawk 321 P.2d 221 (UT 1958). Lake v. Hermes Associates 552 P.2d 126 (UT 1976). Arnold Machinery Co. v. Balls 624 P2d 678, footnote 9 (UT 1981). Buehner Block v. UWC Associates 78 Utah Adv. Rep. 7 (UT 1988). The security agreement, not the note contained other powers.

Respondent states as a finding of fact that the lower court found that "First Federal was aware under the applicable statute of a limitation in the companion agreement". There is no such finding and there is no limitation.

Respondent states as a finding of fact that the lower court found that First Federal was aware "of a claim against the Air

Terminal note". There is no such finding and there is no such claim (R. 498-501).

STATEMENT OF FACTS

In paragraphs 13 and 14 of Respondent's statement of facts (ps. 7,8) it is stated that the two subsequent notes executed by Gump & Ayers to First Federal "replaced" prior notes. The court found in findings of fact numbers 14 and 16 that said notes were "renewal" notes (R. 479).

ARGUMENT

The Note Does Not "Contain" Any Additional Promises Other Than to Pay Money

Air Terminal correctly states that the promissory note to be negotiable must contain no additional promise other than a promise to pay money. Air Terminal's argument that the note "contains" additional promises because it makes reference to the security agreement for additional rights is untenable. It is the separate security agreement which contains any additional rights, not the note. Air Terminal's argument is specifically negated by the official comment on UCC § 3-119(2) which states:

Subsection (2) rejects decisions which have carried the rule that contemporaneous writings must be read together to the length of holding that a clause in a mortgage

affecting a note destroyed the negotiability of the note. The negotiability of an instrument is always to be determined by what appears on the face of the instrument alone, and if it is negotiable in itself a purchaser without notice of a separate writing is in no way affected by it. If the instrument itself states that it is subject to or governed by any other agreement, it is not negotiable under this Article; but if it merely refers to a separate agreement or states that it arises out of such an agreement, it is negotiable. (Emphasis added).

The above quoted official comment specifically rejects decisions construing contemporaneous written documents together when the question is the negotiability of the document, even though otherwise the documents would be construed together. The cases cited in our original brief so hold. The note is therefore a negotiable instrument.

There Were no Limitations in The Separate Agreement of The Rights Under The Note

First Federal was aware of the terms of the contemporaneous agreement, but it was also aware of the fact that there were just additional powers contained in the security agreement and not limitations on the terms of the promissory note.

Air Terminal argues that under the security agreement Sunayers had a duty to indemnify Air Terminal against the Morse problem. Air Terminal then concludes that this indemnification agreement is a limitation on the rights of First Federal under the note and that therefore, First Federal cannot be a holder in

due course. Such an argument is fallacious because First Federal did not assume any obligations of Sunayers or Gump & Ayers under the security agreement. First Federal therefore is not liable on the indemnification agreement. 6 Am. Jur.2d Assignments §109. Nor could Air Terminal offset against First Federal an indemnification claim that may arise against Sunayers or Gump & Ayers. 20 Am. Jur.2d Counterclaim Recoupment and Setoff §89. Air Terminal would have a right to enforce the indemnification agreement against Sunayers or Gump & Ayers but not against First Federal whether the note is negotiable or whether it isn't. The indemnification is not a limitation and the note is therefore negotiable.

Furthermore 70A-3-119 relied upon by Air Terminal for its argument that a limitation in the separate agreement negates the status of First Federal as a holder in due course does not support such a contention. It provides:

70A-3-119

- (1) As between the obligor and his immediate obligee or any transferee the terms of an instrument may be modified or affected by any other written agreement executed as a part of the same transaction, except that a holder in due course is not affected by any limitation of his rights arising out of the separate written agreement if he had no notice of the limitation when he took the instrument.
- (2) A separate agreement does not affect the negotiability of an instrument.

Subsection (1) does not provide that knowledge of any limitation in a separate agreement makes the instrument non-negotiable.

In fact, subsection (2) provides expressly that a separate agreement does not affect negotiability. Also, subsection (1) does not provide that if there is a limitation that that makes the holder with knowledge thereof not a holder in due course. The language of 70A-3-119(1) assumes that one is a holder in due course even though there may be notice of a limitation. Since it provides that a holder in due course is only affected if he had notice, subsection (1) assumes that he is a holder in due course, whether or not he had notice.

The determination of whether one is a holder in due course is set forth in 70A-3-302(1) which provides:

- (1) A holder in due course is a holder who takes the instrument
 - (a) for value; and
 - (b) in good faith; and
 - (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

That says nothing about any knowledge of a limitation.

First Federal Had No Notice of a Claim or Defense

Air Terminal argues that First Federal is not a holder in due course because it had notice of a claim or defense that its obligation under the note is voidable. It argues that it is voidable because of the "Morse problem", and that under 70A-3-304(1)(b) First Federal is not a holder in due course. That section provides:

- (1) The purchaser has notice of a claim or defense if. . .
- (b) The purchaser has notice that the obligation of any party is voidable in whole or in part. . .

The note says nothing about the Morse problem. The security agreement provides only that Air Terminal will be indemnified by Sunayers and Gump & Ayers against any reduction in the share of the capital, net income, net loss or cash available for distribution to which Sunayers partnership interest would be entitled based upon any claims against the partnership by Morse (section 12 of the security agreement). That provision is strictly an indemnification and gives no right whatsoever of avoidance of either the note or the security agreement. Therefore, there is no claim or defense that the obligation was voidable. First Federal is a holder in due course.

Air Terminal next relies upon 70A-3-304(2) which provides:

- (2) The purchaser has notice of a claim against the instrument when he has knowledge that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty.

The quotation used at page 17 of Air Terminal's brief conveniently omits the last phrase "or otherwise in breach of duty". Obviously if the fiduciary Gump & Ayers has not violated any fiduciary duty, the fact that some of the proceeds were used to pay a legitimate debt from Sunayers to its general partner Gump & Ayers would be irrelevant. The above quoted subsection (2) is

inapplicable because of the last phrase "or otherwise in breach of duty". Not only did First Federal not have notice of a claim against the instrument but also there was and is no claim. Therefore, First Federal is a holder in due course.

Furthermore, 70A-3-304(1) which defines a claim or defense would necessarily exclude a situation in which no claim or defense is asserted. Such is the situation here because Gump & Ayers was entitled to retain that portion of the proceeds of the loan it obtained. Not only was there no breach of fiduciary duty by Gump & Ayers, the general partner of Sunayers, Gump & Ayers put its own credit on the line to help the partnership obtain the financing it needed to pay off obligations, including that of the partnership to Gump & Ayers.

Air Terminal misstates the position of First Federal when Air Terminal at page 18 of its brief states that First Federal contends that "Sunayers, and not Gump & Ayers, was the debtor" on the note to First Federal. Air Terminal asserts that Gump & Ayers, and not Sunayers, is liable on the note to First Federal and therefore, Sunayers was not the "debtor". That assertion is correct, but all First Federal is arguing is that the loan from First Federal to Gump & Ayers was made to cover "debts" of Sunayers on its Sunflower project and that because the proceeds were so used, there was no breach of fiduciary duty by Gump & Ayers.

"Claim" and "Defense" Are Not Synonymous

In the sense used here, "claim" connotes an affirmative assertion of a right, whereas "defense" connotes opposition to the assertion of such claim. Had the terms been synonymous the commercial code would not have used both terms in some instances and only one in others. The fact that in one situation it uses defense or claim and in another reverses the order to claim or defense is no indication that they are synonymous.

70A-3-304 defines the notice referred to in 70A-3-302 in defining a holder in due course as "a holder who takes the instrument without notice. . .of any defense against or claim to it on the part of any person". 70A-3-302 provides:

- (1) A holder in due course is a holder who takes the instrument. . .
- (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person. (Emphasis added).

As set forth in our prior brief, there is a differentiation between notice of claim or defense as defined in 70A-3-304 subsection (1) and notice of claim against the instrument as defined in subsection (2). It provides:

70A-3-304

- (1) The purchaser has notice of a claim or defense if
 - (a) the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay; or
 - (b) The purchaser has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged.
- (2) The purchaser has notice of a claim against the instru-

ment when he has knowledge that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty.

Air Terminal argues that 70A-3-306(d) uses interchangeably "claim" and "defense" and that therefore, they are synonymous. That section provides:

70A-3-306

Rights of one not holder in due course. Unless he has the rights of a holder in due course any person takes the instrument subject to. . .

(d) the defense that he or a person through whom he holds the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive indorsement. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party. (Emphasis added).

There is no such interchangeable use. That section states that the claim of a third person to the instrument is not available as a defense to a different party.

The significance of a differentiation is that Air Terminal is wrongfully asserting that there was notice of a claim against the instrument because Gump & Ayers negotiated the instrument for its own benefit and thus, it is asserted, under 70A-3-304 First Federal could not be a holder in due course. As stated above, the negotiation was not in breach of a fiduciary duty, so that argument fails. But even if that were a valid argument, First Federal would still be a holder in due course because there is no

claim against the instrument by Sunayers or anyone else under 70A-3-304(2).

Also 70A-3-306(d), the very statute Air Terminal cites as using "claim" and "defense" interchangeably, bars Air Terminal from raising the defense. In this situation Sunayers is the only third person who could assert a claim to the instrument. Not only is Sunayers not asserting a "claim to the instrument", Air Terminal cannot assert a defense "unless the third person himself defends the action for such party" which Sunayers has not done. Thus, the wording of 70A-3-306(d) that "the claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party" bars Air Terminal from asserting a defense regardless of whether or not First Federal is a holder in due course.

First Federal Did Not "Close Its Eyes"

Air Terminal argues that First Federal closed its eyes to apparent defenses. Presumably, it is referring to what it previously asserted, that the note was voidable or that Gump & Ayers as a partner in Sunayers benefitted from the proceeds of the First Federal loan. Both of these are untenable as discussed above. Hence, there is no basis for the contention that First Federal "closed its eyes".

CONCLUSION

Whether or not the Air Terminal note meets the requirements of the commercial code for being a negotiable instrument depends upon the terms on the face of the note. The terms of the security agreement do not appear on the face of the note and therefore, do not destroy its negotiability.

First Federal is a holder in due course because it had no notice of any defense or claim.

There is no contention by Air Terminal that First Federal had any notice of the alleged fraud which Air Terminal asserts as a defense. Air Terminal should not be able to assert that fraud as a defense against First Federal.

The ruling of the lower court should be reversed.

Respectfully submitted this 5th day of May, 1988.

/s/ John W. Lowe

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